

CENTRAL INTELLIGENCE AGENCY

11 January 1949

INTELLIGENCE MEMORANDUM NO. 119

SUBJECT: Inflationary Trends in Germany

1. The wage-price disparity and the diversion of production and money into irregular channels have produced serious inflationary symptoms in west Germany. A study of the situation leads to the conclusion that unless inflation is checked in the near future the following will probably result: (1) The growing dissatisfaction of the salaried and laboring classes with their low purchasing power will create demands for relief in the form of controls or higher wages. (2) The present non-Communist trade unions must lead or threaten strikes to secure these demands, or lose membership to the Communists or extreme Rightists. (3) An increasing percentage of business will be transacted through black market channels and through illegal trade with the East, to the detriment of western power efforts to effect economic and political stability. (4) Production, already beginning to level off, will decline as labor unrest mounts. Lack of German coal and steel will hamper accomplishment of the European recovery program. (5) All of the conditions existing prior to currency reform will reappear attended by heightened distrust of the western powers' ability to correct them. (6) West Germany, which has achieved satisfactory economic progress in recent months, will become a greater financial burden to the United States, and even less receptive than at present to US policies.

2. In support of the above conclusions, certain observations are pertinent. Slowly growing inflation in west Germany (since currency reform) threatens to impede the considerable progress the region has made toward economic recovery, resultant political stability, and increased industrial production vital to ECA.

The following factors have contributed to the inflationary spiral:

a. Supply continues to lag behind demand in consumer goods and basic commodities. Removal of controls at the time of currency reform meant that the German economy, in order to prevent rising prices, was forced to satisfy through increased output not only current shortages, but also the accumulated shortages resulting from war losses. Despite considerable progress, German production, handicapped by inefficient methods, high cost of raw materials, and power shortages, has begun to

Document No. 061 level off below the volume of output necessary to keep prices down.

NO CHANGE in Class. ☐

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b. Since currency reform the drain of capital from western Germany to neighboring countries and to the East has been accelerated. This capital drain is in three forms:

- (a) a part of regular exports, profits on which are used by exporters to buy deutsche-marks cheaply (thus to lower German production costs and resultant export prices) rather than making them available to the German economy for the purchase of foreign goods. The deutsche-marks are purchased on the Swiss foreign exchange market at the rate of 800,000 a day, priced as low as six cents instead of the official thirty cents;*
- (b) large quantities of smuggled and bartered goods transmitted via illegal channels to neighboring areas;
- (c) reparations which, regardless of principles involved, tend to have a depressing effect on the economy through removal of capital equipment.

c. As wages lag behind prices, loss of real wages has decreased confidence of working and salaried classes in the currency. Since currency reform there has been one wage increase of 15 percent while prices have risen about 40 percent. Labor discontent over lost purchasing power will force the non-Communist labor unions to demand higher wages lest the dissatisfied members look elsewhere for relief. German labor has refrained from strikes in the hope that currency reform would bring price-wage stability. If such stability is not achieved by spring, German labor can be expected to cause difficulties for the western occupying powers.

d. German officials are not enforcing such price controls as remain, nor are they enforcing regulations governing commodity delivery and distribution. Even with production reported (November 1948) at 75 percent of the 1936 level, hoarding and the black market have reappeared. Not only are commodity deliveries insufficient for domestic purposes, but shortages also continue to depress export sales designed to pay for needed imports.

* The initial depreciation of the deutsche-mark on the Swiss exchange was not effected by German lack of confidence in the currency. The depreciation, which took place at the time of currency reform, was caused by or with the connivance of French occupation authorities who exchanged reichsmarks in their possession for deutsche-marks at ten times the legal rate, and sold immense quantities of the cheaply acquired deutsche-marks in Switzerland.

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e. German governmental offices have not responded to efforts of the occupation powers to force reductions in staffs and expenditures. A decrease of employees in one agency is countered by increases in others. The growing obligations incurred by the states constitute a serious drain on west German finances, and thus an inflationary pressure.

f. Business morale and practices, in the past closely regulated by the state, have deteriorated. Despite recent improvements, tax evasion is common. Concerns deliver goods without rendering bills and without entering the transactions on the books. Thus, the markup on items passing from producer to consumer is sometimes as high as 100 percent, no portion of which accrues to the government. Similarly, individual income tax evasion has assumed such proportions that an estimated 1/3 of collectible revenue has been lost in this manner.